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Failed Thrifts: The Resolution Trust
Corporation's Working Capital Needs

Statement of
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Before the Subcommittee on Oversight
Committee on Ways and Means
House of Representatives



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss certain issues related to financing the Resolution Trust Corporation's disposition of hundreds of failed savings and loans. In my statement today I will address RTC's need for working capital, alternative approaches to raising such funds, and H.R. 3469, which would limit RTC's authority to provide indemnifications, guarantee debt, and borrow funds.

In summary we believe RTC does need working capital in order to efficiently and effectively manage the resolution of nearly 600 savings and loans, though we do not know what that need will turn out to be. Furthermore, such working capital should be provided through Treasury borrowing because such an arrangement provides the lowest cost source of financing and preserves the integrity of the budget process. Finally, while we support the intent of H.R. 3469, its broad sweep could significantly jeopardize the RTC's ability to carry out its mission.

RTC's NEED FOR WORKING CAPITAL

The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) provides RTC with \$50 billion to resolve insured savings and loan institutions placed in conservatorship or receivership between January 1, 1989 and August 9, 1992. This amount was based on estimates of what it would ultimately cost to resolve

insolvent savings and loans. This cost was computed as the expected difference between the insured deposit liabilities of such thrifts and the value of their assets. The Act also specifically authorizes RTC to borrow \$5 billion from the Treasury.

The amount of cash needed by RTC in the process of resolving failed thrift institutions will exceed the \$50 billion provided to cover their ultimate cost. This is because assets acquired in the resolution process must be sold in order to realize cash, which may take years. For example, RTC may liquidate a thrift with \$100 million in insured liabilities and assets whose realizable value is \$70 million. Thus, the ultimate cost of this thrift's resolution will be \$30 million. However, RTC must pay out \$100 million immediately, and may not recover the \$70 million from sale of assets for a number of years. During this period, it does not have access to the \$70 million to act on other institutions even though it will ultimately obtain the cash. The \$70 million that RTC needs to carry the assets until they can be sold is the working capital requirement for this hypothetical case.

We have expressed the view that RTC needs working capital on a number of occasions.¹ For example, last June the Comptroller

¹Letter signed by Assistant Comptroller General for General Government Programs to the Honorable Paul E. Kanjorski, House of Representatives, March 24, 1989. Letter signed by Comptroller

General pointed out that there is no fixed relationship between the ultimate cost of resolving the thrift industry crisis, and the cash that will be needed to resolve the troubled thrifts. He added that the Administration's estimate of the funding needs of the legislation did not include RTC's working capital needs.

RTC has estimated that it will have to resolve almost 600 failed savings and loans and in the process will acquire, for subsequent sale, 55 to 60 percent of their assets (as much as \$180 billion), including \$100 billion in difficult, non-liquid assets. Without sufficient working capital, the pace and structure of RTC's resolutions will be dictated principally by the speed with which acquired assets can be sold and the cash recovered. By delaying the resolution of insolvent thrifts which are continuing to lose money, this could substantially increase overall program cost.

We do not know how much working capital RTC will need. That will depend on the methods RTC uses in resolving failed savings and loans, the pace at which the insolvent institutions are closed, prevailing interest rates, the market value of assets in these institutions, the speed with which proceeds from the sale of acquired assets flow in, and the timing of REFCORP borrowings.

General to the Honorable Charles E. Schumer, House of Representatives, June 28, 1989.

MECHANISMS FOR FINANCING
WORKING CAPITAL NEEDS

In recent discussions with GAO, RTC officials have emphasized that a number of possibilities are being considered to raise working capital. Lacking specifics on any of these, we are unable to make a judgement on their merits, or legality. However, I would like to make a few observations.

We have said before and we continue to believe that the lowest cost source of cash needed to supply RTC's working capital would be Treasury borrowing (either directly or indirectly through the Federal Financing Bank). This is also in keeping with our view that government activities should be fully reflected in the budget.

One alternative to Treasury borrowing that has been mentioned would be a nominally private off-budget entity established to hold assets acquired from resolved savings and loan institutions that would use these assets as collateral for borrowings in the market. The proceeds of this borrowing would then be paid to RTC. Such an arrangement, like Treasury borrowing, would accelerate the cash flows from the assets, facilitating RTC's ability to expeditiously act on other unresolved institutions. However, the creation of such an institution whose sole purpose is to tap financial markets for working capital funds to be channeled to an on-budget federal agency would not only be a more

costly way to raise money, but would also represent a further violation of the integrity of the budget process. If, in order to ensure their marketability, the securities were guaranteed, we would be even more troubled, since such an action would constitute a thinly veiled form of federal borrowing.

IMPLICATIONS OF H.R. 3469

You also asked for our views on H.R. 3469. This bill would constrain the RTC, and any other federal entity created after December 31, 1988 with the authority to borrow from Treasury, to borrowing only from Treasury.

We understand the concerns underlying the provisions of H.R. 3469, and are sympathetic with its objectives. However, we believe that the sweep of the bill is so broad as to close off techniques routinely and effectively used in resolving failed depository institutions, such as providing indemnifications and notes in lieu of cash. In addition, because this bill would require RTC to borrow only from the Treasury, but does not increase FIRREA's \$5 billion ceiling on such borrowing, it would limit RTC's access to working capital. The collective effect of H.R. 3469's provisions would be to severely impair RTC's ability to carry out what is widely recognized as an extraordinarily difficult mission.

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In conclusion, we believe it desirable to clarify, as quickly as possible, RTC's authority to raise working capital. It is also necessary to decide on the financing mechanism that will be used. As I indicated, we believe that the solution to RTC's working capital needs lies in approval of a line of credit with the Treasury. In this regard, the RTC should, as soon as possible submit operating and financing plans to its oversight board, specifying its near-term need for financing to resolve its currently scheduled case resolutions.

That concludes my prepared statement. My colleagues and I will be happy to answer any questions.